THE FREEMAN

IDEAS ON LIBERTY

The Open-Endedness of Knowledge: Its Role in the FEE Formula

The New Information Age

Who Will Control Medical Care?

MARCH 1986

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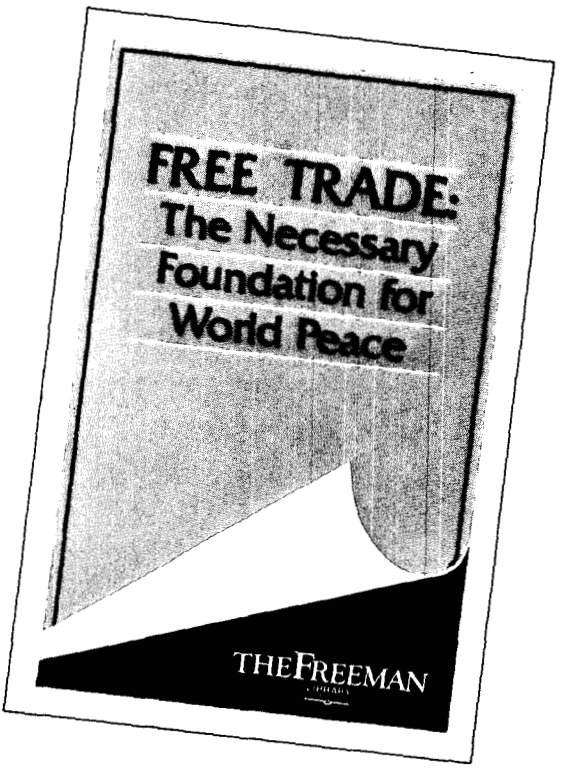
Free Trade:
The Necessary Foundation for World Peace

edited by Joan Kennedy Taylor

At a time when public attention is turning to import quotas and other protectionist measures, many voices are being raised in support of the economics of free trade. But there is a deeper, often neglected truth—free trade can help ensure our survival as well as our prosperity. Protectionism can be seen by other nations as an act of hostility that in itself makes international conflict more likely. Free trade, by contrast, deepens the social bonds among those same nations and makes it in their self-interest to seek the peaceful resolution of conflicts.

To place free trade in this larger context of foreign relations, we have mined the back issues of *The Freeman* and other hard-to-find primary sources. Here are fifteen short essays that discuss such thorny issues as world hunger, industrial superiority, industrial unemployment, the American Revolution, foreign investment, the fallacies of economic nationalism, and how free trade protects our national interests. The thirteen authors represented are William L. Baker, Frederic Bastiat, Clarence B. Carson, Frank Chodorov, W.M. Curtiss, Bettina Bien Greaves, Henry Hazlitt, Samuel H. Husbands, Ludwig von Mises, Gary North, David Osterfeld, E.C. Pasour Jr., and Hans Sennholz.

This is the first volume in **The Freeman Library**, a new series of books that will, from time to time, bring together in permanent form a group of essays that illuminate a single topic. The Introduction for **Free Trade: The Necessary Foundation for World Peace** is by *The Freeman's* publisher, Paul L. Poirot.



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The Workfare Fallacy

"If able-bodied people are to be supported at public expense, then they should be made to work in exchange for support." So goes the defense of workfare.

This plausible statement is a trap for the unwary, another lure along the twisted path at the end of which lies authoritarianism, welfare-state style. It implies that government, not self-interest or necessity, should force the able-bodied poor to work. One recent book on workfare asserts that "For recipients [of government welfare], work must be viewed . . . as an obligation to society." They should work not to pursue their own happiness, not out of free choice, but because "society" requires it, and the government commands it. Lenin would approve.

The key error in this thinking is the false premise that anyone, able-bodied or otherwise, should be supported at public expense. Private efforts made throughout the country to help the poor can be commended. But having the government tax Peter to pay Paul is plunder. If we avoid that, the excuse for drafting the disadvantaged into the labor force disappears. *—HB*

Private Solutions

For several decades, environmentalists have fought the energy companies over the use of public lands. But they have learned to work together in a small corner of southern Louisiana.

The 26,800-acre Rainey Wildlife Sanctuary is a natural habitat for birds and other wildlife. It also contains deposits of oil and natural gas. Since the mid-1950s these deposits have been carefully extracted, without disturbing the habitat.

What is different about Rainey is that it doesn't lie on public land, but is owned by the Audubon Society. Being privately owned, arrangements could be worked out so the environment is preserved, consumers get oil and gas, the energy companies earn a profit, and the Audubon Society receives approximately a million dollars a year in royalties.

The Rainey Sanctuary is a promising, private model for the use and conservation of scarce resources. *—BJS*

FEE's Best Sellers

A recent list of some of the best-selling conservative books in the last forty years failed to mention some of FEE's favorites which would easily make the list. In our fortieth anniversary year, it is appropriate for us to point them out:

- In all of its editions, Henry Hazlitt's wonderful *Economics in One Lesson* has sold over one million copies. FEE has sold about 250,000 of those over the years.
- Approximately 500,000 copies of Frederic Bastiat's *The Law* have come off of FEE's presses since 1950, FEE has sold over 800,000 copies of Henry Grady Weaver's important primer on the history of human freedom, *The Mainspring of Human Progress*, and of course a number of Mises' shorter works would make the list: *Planned Chaos*, *Bureaucracy*, *The Anti-Capi-*

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talistic Mentality, *Economic Policy*, and *Planning for Freedom*.

These are some of the most popular "first source" books for anyone seeking to understand and explain the free market, private property, limited government philosophy.

Two-Way Trade

Most people think of foreign imports as foreign products coming in and American dollars going out. But have you ever wondered what foreigners do with all these dollars?

Consider, for instance, a Japanese auto manufacturer. When he sells us a car, the American dollars he gets won't do him much good in a Tokyo department store. He must take them to a bank and convert them into Japanese yen.

The bankers can't spend these dollars in Japanese stores either, so they are traded on the world market until they wind up in the hands of people who need American dollars to buy American exports. When a foreigner buys an American-made product, he uses the dollars we spent on foreign imports. Trade is a two-way street.

—BJS

Thirty Years Ago

In the March 1956 *Freeman*, John Chamberlain reviewed the paperback edition of F. A. Hayek's *The Road to Serfdom*. He rightly called it "one of the great books of a generation."

The book was originally published twelve years earlier, a timely warning of the incipient totalitarian tendencies of planned economies. Hayek's guiding principle has been an inspiration to many: "A policy of freedom for the individual is the only truly progressive policy."

The Road to Serfdom has been a landmark in alerting generations to the correct path to freedom.

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THE FREEMAN
IDEAS ON LIBERTY

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THE FREEMAN
IDEAS ON LIBERTY

40 Years At FEE

The job of economic education must be undertaken now while those who appreciate the value of liberty are still in a position to support it.

In March 1946, Leonard Read and a small group of colleagues began The Foundation for Economic Education to present the ideas of liberty to a new generation who had no real understanding of the principles and practices of freedom. And yet they would soon reach responsible positions in the business, intellectual, and political life of the country. The task FEE set for itself was to be a first source, to provide the moral and economic case for limited government and a free market economy.

Time has proven the correctness of FEE's approach. The theory, practice, and moral bankruptcy of all the various forms of collectivism are now clearer than ever. The role played by FEE, and all the friends of FEE, is substantial. As the late Dr. Ben Rogge so eloquently said, "Throughout this country, throughout the world there is 'activity of soul' underway that would never have been undertaken but for the work and the inspiration of . . . The Foundation for Economic Education."

In a time of renewed hope in and understanding of the nature of our free society, some people now feel that the battle is over. What a tragic misconception! Without constant vigilance, self-improvement and a growing understanding of the principles behind the renewed faith in freedom, public policy will once again fall back on expediency, coercion and the abrogation of individual rights.

Thus we celebrate our 40th anniversary with appreciation for what FEE has done to improve our prospects for liberty, *and* to look forward to the needs and prospects for the next forty years. The task remains, now more than ever, to understand and communicate the constructive possibilities of the freedom philosophy.

We will celebrate our 40th anniversary in gentle ways throughout the year: by example and through our ongoing programs and activities. Our approach is not a boisterous one.

For that reason we start this issue with an article by Dr. Israel Kirzner. Some of you may be familiar with it, many more will not be. It is a solid, perhaps even inspiring, presentation of two threads in the FEE philosophy. First, it shows how it is that "The free life . . . is at the heart of one's being." Second, Dr. Kirzner, shows how FEE's soft-spoken style is the most appropriate and most effective for presenting the freedom philosophy. □

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The Open-Endedness of Knowledge:

Its Role in the FEE Formula

by Israel Kirzner

Dr. Kirzner is professor of economics at New York University as well as a Trustee of The Foundation for Economic Education. His latest book is *Discovery and the Capitalist Process.*

This article is a shortened version of a talk given at the Annual Meeting of The Foundation on May 15, 1984. A pamphlet version of the talk in its entirety is available upon request.

I intend to explore in this article some aspects of the uniqueness which is FEE, and to express my fervent hope and confidence that such uniqueness will continue to permeate every nook and cranny of FEE's activities in the years to come. I will begin by noting two related but separate paradoxes that have over the years repeatedly caught my attention.

First paradox: FEE's style is one of modesty, humility, tolerance, a steadfast refusal to browbeat those who do not agree with us. Now at least superficially, this attitude of tolerance and modesty appears to be inconsistent with what the late Ben Rogge used to call "FEE's predictability."

> Quite frankly, I know of no other organization on our general side of the street whose position on any given issue is as predictable as FEE's. No ifs, ands or buts. No equivocation. Just right down the line, ramrod straight, for a society based on the principle of anything that's peaceful.[1]

All of us know how Leonard Read used to detest anything that resembled a "leak." Well now, surely this inability to compromise, this apparently intransigent attitude would seem difficult to reconcile with the characteristic courtesy, tolerance and genuine humility of FEE's style. This is my first apparent paradox.

Let me turn to a second apparent paradox. FEE expresses, by its very being, a passionate belief in the sanctity of individual freedom, in the dignity and profound moral worth of a free society. Well, this profound belief surely seems difficult to reconcile with FEE's refusal to evangelize for what it believes in so passionately. If freedom is so sacred, then how can we sit back and refuse to sell it? That is my second paradox.

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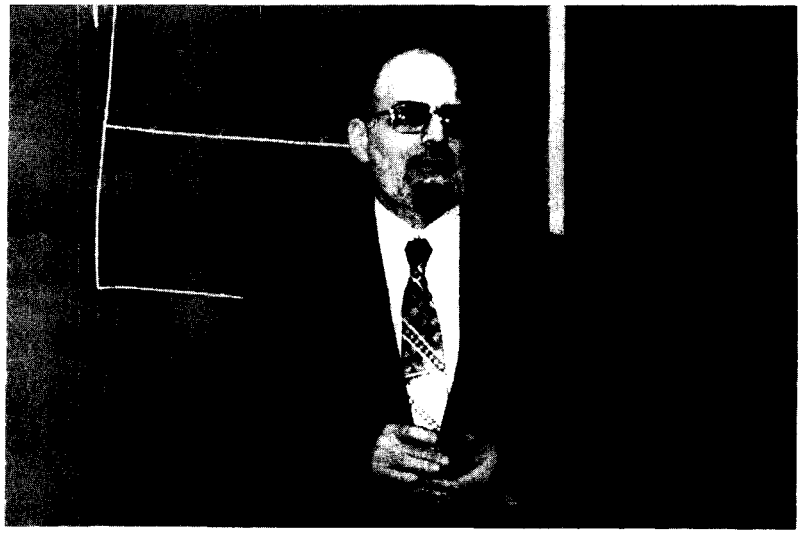

Israel Kirzner BETTINA BIEN GREAVES

The Open-Endedness of Knowledge

The resolution of these apparent paradoxes, I suggest, brings us close to the very core of FEE's mission and its identity. I believe the key to all this can be provided by what I shall call the *open-endedness of knowledge. Knowledge is open-ended in the sense that no matter how much we know, this is as nothing compared with what we know that we do not know.* We all remember Sir Isaac Newton's remark about playing with pebbles of knowledge on the beach while the great ocean of scientific knowledge remains out there untouched before us—a magnificent and lofty thought.

Surely, one critically important premise of FEE's philosophy is this very lively awareness of the limits of our knowledge. So, knowledge is open-ended in the sense of always being seen as incomplete. It is always only a fragment of that which is available to be known.

There is a second idea included as an integral part in this notion of the open-endedness of knowledge. Knowledge is open-ended also in the sense that no matter where the limits and boundaries of one's present knowledge may lie, free human beings possess *an innate propensity to transcend spontaneously those barriers, those limits,* to continually escape those limits, through discovery of new horizons of knowledge the very existence of which was hitherto unsuspected. Life consists, in this sense, of a never-ending series of spontaneous leaps of discovery. The life of freedom is thus a continual expression of the dynamics of continual discovery. The free life, a life for which the open-endedness of knowledge is a central ideal, is one in which the sense of potential—unending potential, unending discovery—is at the heart of one's being. Open-endedness in this sense is the very opposite of the state of stagnancy.

I would like to illustrate and explore the significance of this open-endedness of knowledge for each of *three* separate facets of FEE's philosophy and approach. *First,* the basic understanding of economic relationships. After all, FEE is a foundation for "economic education." *Second,* the deep commitment mentioned earlier to the dignity and fertility of individual freedom. (The "fertility of freedom" is a phrase coined by the late Fritz Machlup; it expresses a profoundly

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important idea.) As to FEE's ideal of a free and peaceful society—what role does the open-endedness of knowledge play in that ideal? *Third,* what role does the open-endedness of knowledge play in FEE's soft-spoken, non-aggressive style of communicating its message and its philosophy to the world?

Open-Endedness of Knowledge and Economic Understanding

Let us consider the first of these three facets of FEE's work—the open-endedness of knowledge as a source of economic understanding. Here I may be excused for referring to the essential differences that separate Austrian economics, the economics that we've learned from Mises and Hayek, from the standard mainstream view. To the standard mainstream view in economics, since about 1930, the view of the world has been one in which the future is essentially known, in which the participants in markets are in effect completely informed about the relative decisions made throughout the market by fellow participants. This is a world of equilibrium, a world in balance, a world in which quantitative economic predictions are entirely feasible. Austrian economics has a quite different view of the world, and a quite different view of the way in which economic relations can be grasped. I quote from Ludwig von Mises:

> The fundamental deficiency implied in every quantitative approach to economic problems consists in the neglect of the fact that there are no constant relations between what are called economic dimensions. There is neither constancy nor continuity in the valuations and in the formation of exchange ratios between various commodities. Every new datum brings about a reshuffling of the whole price system, the whole price structure. Understanding, by trying to grasp what is going on in the minds of the men concerned, can approach the problem of forecasting future conditions. We may call its method unsatisfactory and the positivists may arrogantly scorn it. But such arbitrary judgments must not and cannot obscure the fact that understanding is the only appropriate method of dealing with the uncertainty of future conditions.[2]

It was Mises' disciple, Friedrich Hayek, who fully explained the importance for economic understanding of recognizing the limitations of knowledge. It was as a result of his attempt to explicate the Mises-Hayek side of the celebrated socialist economic calculation debate that Hayek first articulated the significance for market competition of dispersed information. Hayek taught us that the crucial element in market competition is the circumstance that knowledge is never concentrated in a single mind—always dispersed. We never know everything. None of us. No single mind can possibly know everything. No single mind can possibly grasp the entire economic problem that tends to be solved through spontaneous market processes. In more recent work, Hayek has emphasized the character of market competition as, in his terminology, a *discovery procedure*—and I quote:

> Competition is . . . first and foremost a discovery procedure. No theory can do justice to it which starts from the assumption that the facts to be discovered are already known. There is no predetermined range of known or "given" facts, which will ever all be taken into account. . . . The real issue is how we can best assist

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> the optimum utilization of the knowledge, skills and opportunities to acquire knowledge, that are dispersed among hundreds of thousands of people, but given to nobody in their entirety. Competition must be seen as a process in which people acquire and communicate knowledge; to treat it as if all this knowledge were available to any one person at the outset is to make nonsense of it.[3]

Hayek's broader philosophy has proceeded from these fundamental insights to appreciate their even more far-reaching implications. And Hayek in fact says that, "Civilization rests on the fact that we all benefit from knowledge which we do *not* possess."[4]

So far it might seem that these Austrian insights rest fundamentally on the awareness of human ignorance, on the limitations of human knowledge, but in fact they rest also on that second element in the open-endedness of knowledge that I have referred to. These insights rest, that is, also upon an appreciation for the propensity within human action to discover what was hitherto unknown—what I like to call the *entrepreneurial* propensity in human action. It is this propensity that is responsible for entrepreneurial alertness for pure profit opportunities, for entrepreneurial discovery, for bursting asunder the limits of existing knowledge. It is upon this alertness that we rely for the manner in which the market continually propels prices and decisions in the direction of greater mutual coordination. It is entrepreneurial alertness to existing errors that leads to their discovery and their eventual tendency to be corrected.

Commitment to Freedom

Let me turn to the second of the three applications of the open-endedness of knowledge: the importance of the open-endedness of knowledge for our commitment to the dignity of freedom and its fertility in a free society. Here a great deal depends, I would suggest, on our instinctive recoil from the arrogance of benevolent dictatorship. Let me quote Leonard Read here:

> There are numerous virtues and vices that account for the rise and fall of societies. Near the top of the list, are the two opposites, humility and pride . . . Pride sprouts and grows from ignorance and self-blindness. Those with a haughty spirit foolishly believe they know the most, whereas they know the least. While they don't know how to make a pencil, or why grass is green, or who we are, they "know" how to run our lives. In their blind pride, the least taste of political power drives them to become power addicts. Until such persons seek help there is little we can do to curb their addiction. What we can and must do is to develop in ourselves the strength of character to resist the temptations of power.[5]

I would suggest that our disgust for the arrogance of dictators is only part of the story. Surely, our commitment to a free society rests also on our appreciation for the immensely valuable spontaneous discoveries that the human spirit can generate when left free. It is our admiration for individual creativity that is responsible for our reverence for the free society. So here we have both of those elements in the open-endedness of knowledge—undergirding our regard for freedom in a free society: (1) our recoil, our disgust for the arrogance of

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those who believe they know how to run other people's lives, and (2) our awareness, our appreciation for the propensity in human beings to continually expand what they know, what they can create.

FEE's Style

Let me turn to the third aspect of FEE's work and illustrate the significance of the open-endedness of knowledge for FEE's unique style and approach in communicating its message to the world. Here I think two points of contact ought to be noticed between the open-endedness of knowledge and FEE's characteristic style. We recall that this style involves first of all an innate courtesy, modesty and tolerance. (No name-calling, Leonard Read taught us, no arrogance!) Second, the FEE "style" reflects a confidence, a faith, if you like, that those who can benefit from our message *will find us almost of their own accord.* They will discover us. Certainly this confidence is a remarkable feature of FEE's style.

I have one final quote from Ben Rogge, taken from a high school commencement address. He was talking to these youngsters about what they might expect of college. Ben said:

> Hopefully, you will . . . come to know how little you know, in fact how little is known about man and his world by even the most knowledgeable around you. This is to say that you may come to carry with you through life a deep sense of wonder and of awe, not of what you do understand, but of the deep and mysterious processes which neither you nor anyone else fully understands.[6]

Open-endedness of knowledge is the root of FEE's modest, tolerant style. But then we said there was another aspect to that style—the confidence, the faith, that those who can benefit from our teachings, from what we have to offer will find us out, will seek us out. Listen to Leonard Read:

> Forget the "selling freedom" notion! Right method calls for concentration on the improvement of the most approachable person on earth—one's self. This is practical because accomplishment is possible. This tactic disposes of the numbers problem, the impossible—selling the masses. Do not seek followers! . . . What seek ye then? The achievement of understanding and clarity of explanation . . . so that those who wish to learn may come upon enlightenment. If you are successful, those with inquiring minds will find you out.[7]

Here, surely, we have Leonard Read thinking of the spontaneous discovery potential that will bring our audience to our doors. If we hold up the standard, if we show them what a free society means, they will find us out.

Let us return to the two apparent paradoxes that I mentioned earlier. I believe that it should be easy to see that these paradoxes dissolve immediately just as soon as we recall the significance of this open-endedness of knowledge. We asked how a passionate commitment to freedom could be reconciled with an attitude that refuses to go out and sell the freedom principles to others. We asked how FEE's refusal to compromise, refusal to recognize exceptions could be reconciled with its attitudes of modesty and tolerance. But these questions are easily answered.

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A passionate love of freedom as well as FEE's modest style and courtesy *both* grow out of our awareness of our own fallibility and of the arrogance of those who presume to know enough to control others. We know how little we know!

If we appear uncompromising, this is because we are absolutely sure of this one thing that we know with certainty; that is, that human knowledge is open-ended and inescapably limited.

Concerning this item of knowledge, we cultivate no false modesty. We know for sure how little we know. And we know for sure how this open-endedness of human knowledge is responsible for the spontaneously coordinated operation of free markets. And we know for sure how this vitiates so much fashionable economics.

We have begun to understand the open-endedness of human knowledge—including the potential for spontaneous discovery that rests in the human breast. This understanding nourishes our conviction that what we need to do is to deepen our own understanding of the nature of a free society with full confidence that others will seek us out. We do not need to sell. We do not need to attack, to indulge in name-calling.

The Formula for FEE's Future

In a word, FEE's unique style, its unique and quietly passionate commitment to a free society, its commitment to the basic principles of sound economic understanding—all of these fit cohesively into a single integrated whole. This I submit is an important element in FEE's formula. I believe that a renewed self-appreciation for these basic principles can continue to provide stimulation and motivation for FEE's activities for many years to come.

I believe that by mobilizing the dedicated and informed enthusiasm of those many thousands of persons connected with FEE, we can proceed to translate these abstractions—and they are abstractions—into the day-to-day activities of FEE.

Let us never lose our courtesy and our tolerance. Let us never forget our distaste for the arrogance which lies at the root of all threats to a free society. Let us never lose our confidence in intellectual alertness of a free citizenry. Let us persevere in our search for understanding in our economic studies.

We need never fear new ideas. We need never be unsure concerning new proposals, provided we appraise each one of them against our own standards and our own criteria involving leak-proof economic understanding, unified with unfailing courtesy to others in the way in which we reveal our own passionate love of freedom. Let the open-endedness of human knowledge be our inspiration and our guide as we navigate our way through a future of limitless possibilities for free human beings. □

1. Benjamin Rogge, "The Power of Tomorrow: Whither FEE?" mimeographed version of talk given to FEE Fall meeting, November 18, 1979, p. 4.
2. Ludwig von Mises, *Human Action* (New Haven: Yale University Press, 1949), p. 118.
3. F. A. Hayek, *Law, Legislation and Liberty, Vol. 3: The Political Order of A Free People* (Chicago: University of Chicago Press, 1979), p. 68.
4. F. A. Hayek, *Law, Legislation and Liberty, Vol. 1: Rules and Order* (Chicago: University of Chicago Press, 1973), p. 15.
5. Leonard E. Read, *Liberty: Legacy of Truth* (Irvington-on-Hudson: Foundation for Economic Education, 1978), p. 15.
6. Benjamin Rogge, *Can Capitalism Survive?* (Indianapolis: Liberty Press, 1979), p. 280.
7. Leonard E. Read, *Liberty: Legacy of Truth, op. cit.* p. 62.

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Bocce and the Economics of Collusion

Without government intervention, monopolistic agreements are inherently unstable.

by James Doti

Dr. Doti is Dean of School of Business and Management, Chapman College, Orange, California. The names of the characters in this article are fictitious.

It's all in the wrist. That was my conclusion after learning the basic techniques of bocce from my Uncle Rocco (Si Rocco). The lessons consisted mainly of his shouting in my ear, "Don't-a roll the ball; you pull-a the ball and-a throw, like-a this."

The pull-throw served me well. After moving to Chicago's "Little Italy" to attend a nearby university, I was recruited during my second summer in the neighborhood to play in the legendary Sons of Italy Bocce League. The four-man team I played on was called "The Undertakers," which in addition to myself consisted of three local area morticians.

The importance of the bocce games was reflected by the team's post-game meetings at the neighborhood conference center—Whitey's Tavern. It was there under the backdrop of moving water scenes from the "land of sky-blue waters" and crudely patched plaster walls that many business decisions in the neighborhood were made. Even in the case of our post-game wrap-up which ostensibly took place to review our team's performance, it turned out that the supply of local funeral services also hung in the balance.

After roundly attacking each other's performance at bocce, the business part of our meeting would usually start with Nick Mortadella, owner of Mortadella and Sons Funeral Home, saying something like, "What are we gonna price the new fake bronze caskets at? We go too low; nobody'll buy da real ones."

It usually took a while before Vinnie and Sal Sallamagotta, owners of Sallamagotta Bros. Funeral Parlor, could change their thought processes from bocce to business.

"Well, did ya hear me? Whatta we price it at?"

Getting no response from the brothers, Vinnie suggested, "Listen, how 'bout if we all agree that we don't buy da fake one."

We all looked over to the elder brother, Sal, who was busily engaged in examining a fennel seed on the pizza he was eating. When he realized a reply was in order, Sal gave a characteristic shrug of acceptance.

So it was that imitation bronze caskets never made inroads in Little Italy's funeral parlors.

The harmony demonstrated by my team members' ability to compromise and work in consort at their weekly meetings at Whitey's turned out to be short-lived. War clouds were clearly evident one Friday evening when I noticed a milling of people outside Sallamagotta Bros. Funeral Parlor. Getting closer to investigate, I saw Nick Mortadella standing outside in the street staring daggers at the hubbub of

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people. When I asked Nick what was going on, he motioned for me to follow him.

Nick walked into his competitors' funeral home and led me down into the basement where coffee and cookies were generally served to the mourners. But in place of the usual aluminum tray of store-bought cookies was a "sweet table" filled with a bountiful supply of the most luscious-looking Italian pastries that I have ever seen. People wandered with delight around the table as they ogled cannoli, pasticiotti, spugliatelli, and zeppoli. In fact, if it were not for the fact that we were in the basement of Sallamagotta Bros. Funeral Home, I would have thought we were at a first-class wedding reception. Indeed, except for Nick who still glowered, everyone seemed to be in a festive spirit. One mourner was heaping pastries on his platter when he nudged Nick and said, "Hey Nick, what are ya going to do to top this? Haw Haw."

I was just about to select an especially delicious-looking cannoli from the table when Nick pulled me away and said we have to go and talk to Sal. Upstairs we found a stoic-looking Sal wearing a dandruff-flaked pinstripe suit and positioned in front of the main parlor greeting mourners. When he saw the austere expression on Nick's face, he said to wait for him at his home. Since his home was attached to the funeral parlor, all we had to do was walk behind the curtain where some poor soul was "laid-out" to be at Sal's back door.

Mrs. Sallamagotta, a portly woman whose cheerful personality be-

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lied her association with the funeral business, greeted us warmly. After leading us into the living room, Mrs. Sallamagotta brought us coffee and cannoli, the familiarity of which intensified Nick's anger.

When Sal finally arrived, he looked at the uneaten cannoli on Nick's plate and said, "Whazza matter Nick, don't-a you like-a the cannoli?"

Nick exploded with several rhetorical questions: "Forget da cannoli. Whatta ya think is going on here? Are we in da catering business or something?"

From here the argument quickly generated into the type of shouting match where the logical basis of an argument is far less important than the decibel level in which it is carried out.

The unresolved nature of the shouting match was obvious as Nick yelled a final insult at Sal and then indicated to me that we make a rapid exit. As we left, Mrs. Sallamagotta grabbed each of our hands and wrapped them around the strings that held a bakery box full of leftover pastries, an offering that Nick did not refuse.

Outside in the street, Nick was still seething. "Wait till he sees what I can do . . . he hasn't seen da last of dis . . . two people can play his game."

Pricing Agreements: Why Monopolies Are Unstable

In his monumental work, *The Wealth of Nations,* Adam Smith discusses the ease in which monopolistic pricing agreements among competitors can be made: "People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices." (*The Wealth of Nations,* Modern Library edition, 1937, p. 128.)

The collusion that took place between funeral home owners during the post-game meetings at Whitey's is the same type of collusion that has occurred at one time or another in every sector of an economic system.

During the 1950s, a conspiracy among electrical goods suppliers involving such industrial giants as General Electric and Westinghouse took place. Following a costly price war that occurred in the transformer and switchgear electrical goods industry in 1954-55, profits in that industry tumbled. As a result, pressure was placed on key executives to turn the profit picture around.

In an article that presents a detailed review of the electrical conspiracy, Richard Austin Smith explains how the collusion was facilitated over several rounds of golf:

> At the Switchgear Division (General Electric), the pressure was so great that a lifelong believer in tough competition underwent a remarkable conversion. He called a department manager into his office and told him the old cartel was to be cranked up again . . . Shortly thereafter, they trotted off to mix in a little conspiracy with a little golf in Bedford Springs, Pennsylvania. Every month that year one company conspirator would initiate a memorandum to the others . . . listing every pending job whether sealed bid or open and stating what the calculated book price would be. Then the conspirators would reassemble and compare calculations to forestall any chiseling from the agreed-upon book. (*Fortune,* "The Incredible Electrical Conspiracy," April, 1961, p. 172.)

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The similarity of the electrical conspiracy with my experience in Chicago's Little Italy should not be surprising. Rewards from evading competitive market forces can be substantial. This can be more clearly seen by considering a simple example.

Assume that a funeral home owner incurs 300 dollars of additional costs to produce funeral services worth 1,000 dollars of increased revenue. Each "customer" is therefore worth 700 dollars ($1,000 – $300) in additional profits to a funeral home owner.

The situation changes, however, if a new competitor enters a market. There is a greater likelihood that price-cutting will take place as each competitor strives to increase market share. Indeed, the collusion typified by the post-game meetings at Whitey's Tavern and that among major electrical goods suppliers over a round of golf represent attempts by individuals to prevent competitive market forces from eating into monopolistic returns.

Unstable Agreements

Fortunately, monopolistic agreements among competitors tend to be highly unstable and short-lived. One need not look far to see the reason for such instability. In the numerical example presented above, each additional "customer" to a funeral home represents $700 of additional profits—certainly a healthy inducement to violate monopolistic pricing agreements. To avoid retaliation, the initial violations often involve giving customers hidden discounts or providing additional services rather than announcing actual price cuts. Hence, the initial violation in the funeral home business of Little Italy involved providing a bountiful sweet table in place of store-bought cookies. In the case of the electrical goods conspiracy, the initial violations involved under-the-table price cuts:

> Westinghouse had proposed to Florida Power that it add all its circuit-breaker order (about a million dollars worth) to its order for Westinghouse transformers. In return, Westinghouse would take 4 per cent off circuit-breaker book and hide the discount in the transformer order . . . Retaliation was not long in coming. Westinghouse went to Baltimore Gas and Electric . . . and said they would give 5 per cent off on switchgear and circuit-breakers, and a week later Allis-Chalmers gave Potomac Electric 12 per cent off. A week after that, Westinghouse gave Atlantic City Electric 20 per cent off, and it went down to much worse . . . in the winter of 1957-58 prices were 60 per cent off book. That was the end of the cartel. (*Fortune,* p. 176)

Even if one were to unrealistically assume that the participants in collusion abide by iron-clad agreements and are successful in preventing violations, there is still to consider the likely entry of new competitors into the market. Of course, a new competitor could be asked to join the cartel, but that would generally mean that a given level of profits would be divided among more participants resulting in smaller profit shares for all. In addition, a greater number of participants in the cartel increases the likelihood that the agreements will be violated and therefore increases the enforcement costs of the cartel. The recent experience of the OPEC cartel is a case in point. The only way a cartel can become permanently entrenched is to elicit the aid of government by making competition illegal.

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In retaliation to the Sallamagotta brothers' sweet table, Nick Mortadella's opening salvo was to distribute felt-backed holy cards at funerals instead of the cheaper and more ordinary paper ones. When this strategy failed in generating the interest he hoped for, Nick resorted to lowering his base-rate charges for funeral services.

Meanwhile, the Sallamagotta brothers found the additional number of mourners generated by their sumptuous sweet table getting out of hand. People were coming from as far as Gary, Indiana to partake in the goodies. When the Sallamagotta brothers finally put an end to the sweet table and followed Nick's price cuts, a funeral home price war had begun.

It is difficult to imagine where events would have turned were it not for an unforeseen business development in the neighborhood. The change was evident during an unusually peaceful bocce game that was devoid of the acrimonious display of insults that had characterized recent play.

Something was definitely in the wind as we all agreed to meet together at Whitey's. It was like old times sitting in our usual red vinyl booth. This time, though, we skipped the bocce talk as Nick moved immediately to the business at hand.

"OK, ya all know dat Frenchy is gonna open up a new funeral home in da neighborhood. Whatta we gonna do?"

Frenchy, a neighborhood local of questionable French ancestry, owned a funeral home in nearby Greektown. Evidently, Frenchy's move to expand his market share was behind the team's renewed spirit of cooperation.

"We've already dropped our prices," said Nick diplomatically avoiding mention of the factors that led to this turn of events. The intensity of Nick's feelings was evident when in a highly charged and emotional tone he said, "If we get anoder funeral home, we won't feed our families."

"I checked with da Alderman's boys. We pay three grand; dey won't give Frenchy a license—simple as dat," said Nick in the self-satisfied manner of a person who had obviously done one's homework. He added that the payoff would be made next week to Alderman Cooley's local precinct captain after the bocce games.

"There's one hitch," cautioned Nick whose sly smile implied there was no hitch at all. "Da alderman is catching heat from Alderman Czebinski; I guess da funeral homes in his ward don't much like our prices. We make peace and go back to our old prices, or Frenchy gets da license."

A round of clinking beer steins suggested that peace and order was again restored in the funeral trade in Little Italy.

The following week, after a brilliant round of bocce with my pull-throw in top form, I looked forward with silent anticipation to celebrating our bocce victory. As we walked towards Whitey's, Nick in an obviously embarrassed and self-conscious tone said, "Da precinct captain don't want ya to be dare when we pay im da money. Meet us later at Sal's."

I understood. The precinct captain's pull in City Hall was far more important than the bocce pull I learned from Uncle Rocco. □

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The Legacy of Karl Marx

How the Communist Manifesto fails as an economic guidebook.

by Henry Hazlitt

Henry Hazlitt has had a long and distinguished career as economist, journalist, and author. Best known of his numerous books is *Economics in One Lesson.*

A number of women (and men) have recently been contending that women who are just as productive as men are being employed on the average for only about 70 per cent as much pay, and that the statistics prove it.

I am not going to quarrel with the comparisons of men's and women's actual wages, but with the contention about productivity. In a market in which competition is permitted between employers and between workers, the situation ascribed could not long exist. What would prevent it, what does prevent it, is the selfishness of employers.

Let us suppose that there was an industry in which both male and female workers were producing enough to bring the employer an ascertainable added profit of just over $10 an hour, but in which the men workers were receiving $10 an hour, and the equally productive women workers only $7 an hour.

It would soon occur to an unscrupulously selfish employer that he should henceforth employ only women workers from which he could make a net $3 more an hour than from his male workers. He would let his men workers go. Other employers would follow his example, and for the same reason. But this would mean that the female workers would start demanding higher individual wages until their pay was on an equality with that previously received by males.

In other words, selfish employers would prefer to make only $2 an hour net by employing female labor at $8 an hour rather than see competing employers make $3 net out of them. They would even choose to make only $1 an hour net by paying them $9 an hour rather than stand by and watch other employers making $2 net out of them. This would continue until prevailing female wages in that industry were

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very close to female labor productivity in dollar terms. (In the long run, of course, there would be no drop in the prevailing men's pay, because their productivity would still make it profitable to employ them at that rate.)

To state this more briefly and bluntly, any employer would be a fool to hire male workers for $10 an hour when he could hire equally productive women workers for $7 an hour.

There are, it is true, special conditions, temporary and localized, in which labor productivity might not be the dominant factor in determining wage levels. In a small mill town, for example, in which there was only one mill, not large enough to employ the entire working population, the wages paid by that mill might fall below the worker-productivity level. But this would tend to prove only a temporary situation. Two developments would be likely to change it. The unemployed surplus workers would start to leave for other towns. And the mill owners would be tempted to reinvest their profits and expand their operations.

So far, I have been writing about the factors that tend to eliminate wage discrimination on sexual grounds where it exists. But the same considerations would also tend to eliminate wage discrimination on grounds of color, race, nationality, or other reasons. Where such wage differences persist, they tend to reflect real differences in productivity.

Let me now carry my contention a giant step further. The selfishness of individual employers is the force that, under competitive capitalism, brings the level of wages up close to the full value of the productivity of the workers.

Of course, there are never conditions of perfect competition; of full knowledge on both sides, employer and employed, of their respective opportunities. There are individual accidents, immobilities, prejudices, and other factors that prevent everybody's wage or salary from corresponding with the approximate value of his or her contribution or output. But this correspondence is the dominant long-run *tendency.*

There is nothing original in this explanation. I have simply been stating, in fact, in an unusual form, what is known as the marginal productivity theory of wages. This is the theory held by the overwhelming majority of serious economists today.

The Marginal Productivity Theory of Value

This theory was astonishingly late in its development. It did not make its appearance until the very end of the 19th century, in the principal works of the Austrian economists, Carl Menger (1871), Friedrich von Wieser (1884) and Eugen von Böhm-Bawerk (1884), and of the American economist John Bates Clark (1899).

Why did its development take so long? It took so long partly because the field was already occupied by other theories—wrong theories. And how did they in turn get started? They got started partly through the errors of writers that were in some respects acute and even profound thinkers. The first of these was the economist David Ricardo (1772-1823), who, by abstract reasoning, developed a labor theory of value in which the contributions of capital investment, initiative, invention, and management somehow got buried.

Then, along came Karl Marx. Ostensibly taking off from Ricardo, he presented a pure "exploitation" theory of wages, and declared out-

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right that as long as the "capitalist system" continued in existence there could be no real improvement in the condition of workers.

This assertion was made in the face of some very noticeable improvement in the economic condition of the "masses" before 1848, when the *Communist Manifesto* was published, and certainly in the remaining 35 years of Marx's life.

Doubtless there was some excuse for Marx's failure to notice this improvement. In the early years of his life some relics of the medieval system were still around. Great tracts of land were still held by princes, dukes, and barons, and the men who tilled the soil were often forced to pay excessive rents. Production was by our present standards incredibly low. Capital goods—tools, implements, machinery, vehicles, and other equipment—were still rare, crude and primitive. There was a scarcity of donkeys, horses, and other farm animals. On the farms, human beings were forced to carry great burdens on their own backs, as they still do in China today. Only very slowly were more capital goods produced. The great bulk of labor went into producing tomorrow's food and other necessities.

But let us now turn to the actual text of the *Communist Manifesto*. That document, of approximately 40 pages, was written by Karl Marx and Friedrich Engels partly as a call for civil war—"Working men of all countries, unite!"—partly as propaganda, and partly to explain the economic theories of Communism to the workers. But the reader will look in vain to find those theories spelled out in any reasoned form.

We are told that there are two main classes in society—the "proletariat," which consists of the "workers," employed and unemployed, and forms allegedly about nine-tenths of the population, and the "bourgeoisie," which consists of the employers and a few other groups who are comfortably well off. The bourgeoisie rule. They hire the proletariat; and because they do, they necessarily "exploit" them. The only way this dreadful situation can be changed is by revolution, in which the proletariat must seize all the property of the bourgeoisie, and, if they object, kill them.

The Marxist Exploitation Dogma

No explanation is offered in the *Manifesto* of how this "exploitation" is possible, or what is its exact extent. The word implies that the employers pay their workers only a fraction of what they are worth—of what they add to production or profits. The fraction is not mentioned. Let us say it is only 50 per cent. As individual employers would be making such a big profit at that rate, and would obviously want to hire workers away from other employers, what stops them? The exploitation theory implies that the employers must all be in some secret agreement to keep wages down to this existing near-starvation level, and maintain it through the most drastic penalties against humane employers, if any, who attempt to offer more. "The average price of wage-labor is the minimum wage, i.e., that quantum of the means of subsistence which is absolutely requisite to keep the laborer in bare existence as a laborer."

All this is pure fiction. The exploitation theory implies that the wage-level cannot rise. In trying to maintain this, the *Manifesto* quickly falls into inconsistencies and self-contradictions. We are told that: "The bourgeoisie, by the rapid improvement of all instruments of production . . . draws even the most barbarian nations into civilization. The

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cheap prices of its commodities are the heavy artillery with which it batters down all Chinese walls . . . The bourgeoisie, during its rule of scarce one-hundred years, has created more massive and more colossal productive forces than have all preceding generations together," with "whole populations conjured out of the ground."

But this enormously increased production could not have been possible without equally increased consumption. The increased population that the increased production made possible must have consisted mainly of the proletarians, and the increased production itself could only have taken place in response to an increased demand. This demand must have been made possible by increased purchasing power, and that in turn either by increased wages or lower prices. But nowhere in the *Manifesto* is this necessary chain of causation acknowledged. The exploitation dogma blinded Marx to the obvious.

The *Manifesto* keeps compounding its economic errors. Obviously capital—which is most usefully thought of as capital goods—is used because it increases production. And because it increases production, it must increase the income of the owner or user. The carpenter would get nowhere without the use of hammers, saws, chisels, and even more elaborate machinery. And so for all other artisans. These tools and machines must at least promise to "pay for themselves" before they are acquired.

Yet we find the authors of the *Manifesto* writing: "In proportion as *the use of machinery* and division of labor *increases,* in the same proportion the burden of toil *increases,* whether by prolongation of the working hours, by increase in the work exacted in a given time, or by increased speed of the machinery, etc." [My italics.] Even if the reduction in weekly working hours recorded through the years did not show this *Manifesto* statement to be false, it was nonsense on its face. Yet Marx and Engels go on: "Machinery obliterates all distinctions of labor, and *reduces* wages to the same level!" [My italics.]

The Historical Record

From the 1830s on, however, the historic record shows a reduction of hours and an increase of wages from the introduction of machinery. Prof. W. H. Hutt, in his essay on *The Factory System of the Early Nineteenth Century,* writes: "That the apparent benefits wrought by the early Factory Acts are largely illusory is suggested by the steady improvement which was undoubtedly taking place before 1833, partly as a result of the development of the factory system itself." (*Capitalism and the Historians,* edited by F.A. Hayek, p. 181.)

Tooke and Newmarch, in their book *A History of Prices From 1792 to 1856,* publish extracts from a report issued by the City Chamberlain of Glasgow in 1856. This records that in 1856 wages of skilled labor in the building trades (masons, carpenters, and joiners) increased 20 per cent from the level of 1850–1, and wages of unskilled labor 48 per cent in the same period. He attributes this principally to "increased production in consequence of improvements in machinery."

"It must also be borne in mind," he adds, "that weavers and spinners worked 69 hours per week in 1841 and only 60 hours in 1851-6, and hence received in 1851-6 more money for less labor." He also notes at another point that in 1850: "The number of hours per week worked by masons, carpenters and other artisans employed in the building

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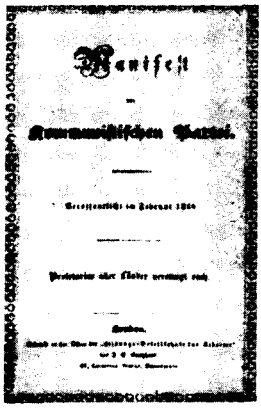
trades was 60 hours, or six days of 10 hours each, with a deduction of 1½ hours for meals. Since 1853, the weekly time has been reduced to 57 hours."

For the United States (which seems to have lagged greatly behind England), the official publication, *Historical Statistics of the U.S.: Colonial Times to 1957*, reports (p. 90) that in 1860, the weighted average of working hours in all industries was 11 hours a day (Monday through Saturday inclusive), and that by 1891 this had fallen to 10 hours. In 1890, the working week was 60 hours (6 times 10 daily) and by 1926 had fallen to 50.3.



Recent issues of government publications, the annual *Statistical Abstract* and the current monthly *Economic Indicators,* show that the average of manufacturing hours fell from 51 a week in 1909 to 39.8 in 1957 and to 35 in 1985. Thus average working hours per week under capitalism, in other words, show a steady fall for nearly a century and a half.

In the *Manifesto,* our two authors mention frequently how "the competition between the workers" undermines solidarity and reduces wages. But they never once acknowledge the existence of competition among employers for workers. It is precisely this that brings wages up to the value of the workers' specific contribution to output. And this is not because the employers have or need to have any altruistic motives, but simply the motive of maximizing their own individual profits.

The Ominous Appeal of Hatred

Karl Marx must himself later have felt a great deal of misgiving about the lack of any real explanation of the maleficent workings of the existing economic system that he had portrayed in the *Manifesto.* For in 1867 he published (in Germany) a volume entitled *Das Kapital.* This was apparently intended to be the first of further volumes, but though Marx lived to 1883, nothing more appeared. Some commentators have surmised that Marx had reached an impasse, and could not decide how to continue. After Marx died, Engels undertook to "complete" the work in three volumes by supplementing his friend's unfinished manuscripts. The Austrian economist Eugen von Böhm-Bawerk thoroughly demolished the argument of the finished work in his *Karl Marx and the Close of His System* (1896), a masterful refutation that does not have to be done again.

Let me remind the reader once more that the thesis with which I began this piece—that the assumption of pure selfish competition on the part of the employers would be enough to explain how workers on the average receive practically the full value of their productive contribution—is only a novel way of presenting the marginal productivity theory of wages, now accepted by the overwhelming majority of present-day economists.

The factual substantiation of that theory is particularly impressive in the United States. The annual report of nonfinancial corporation earnings, going back for more than thirty years, show that the employees today receive an average of about 90 per cent of corporate gross earnings in their wages and the stockholders only about 10 per cent in their profits. In fact, a man's personal income often seems to have little to do with whether he is technically an employee or an employer. A baseball, football, basketball, or prize-fighting star may

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"Under competitive capitalism the self-interest of individual employers is the force that brings the level of wages up close to the full value of the productivity of workers."

receive an income in the million-dollar range, far above that of the promoter who technically employs him. It is a result of the star's "productivity"—his box-office appeal. It is the competition among promoters, employers, that brings this about.

Selfish Capitalists vs. the Communist Manifesto

From the standpoint of common sense, the appeal of the *Manifesto* to violence and class war seems entirely needless. If the proletariat (supposedly some nine-tenths of the population) would be better off under a Communist economy, all that was necessary was to make this clear to them, and they could be trusted to vote themselves into power and such an economy into being. (Democracy was emerging in Britain in 1848, and, for whites, already functioning in America.)

But such an appeal gave little promise of starting a "movement" or leading to early political action. Marx and Engels were agitators, activists—and shrewd psychologists. They knew that most people who find themselves at the bottom of the economic ladder are tempted to put the blame, not on themselves, but mainly on somebody else. The exploitation theory, however weak as an economic doctrine, was tremendously persuasive psychologically and as a call for action. It was an essential part of their propaganda.

So, though the *Communist Manifesto,* even in its own time, failed completely as an economic guidebook, it did succeed thoroughly in instilling class hatred. This hatred, unfortunately, has been its most permanent contribution. It was originally directed ostensibly against a special class, the bourgeoisie—the employers, and all those comparatively well off—in revenge for "exploiting" the workers.

But, with the passing years, the target of this hatred has been quietly changed. As the employing class in Russia was liquidated by various means, a still existing group had to be substituted. To stay in command, a dictatorship must continue to point to a powerful enemy to be feared and destroyed. Fortunately, such an enemy can still be pointed to. It is the "capitalist" nations as a whole, especially the United States. Sixty-eight years after the Bolshevik Revolution, most of the American population is notably better off than the population in the Soviet Union. Though Russian school children are taught that we are an "imperialist" nation, the American "proletariat" are now tacitly included, as the Russian "bourgeoisie" once explicitly were, among the people to be envied and somehow blamed for the plight of the Communist-ruled countries.

This newly directed fear and hatred are ominous. They have led to an enormous armament buildup in Russia, and to the development and storage of multiple nuclear weapons which are forcing the West to try to keep uneasy pace. None of us can foresee the ultimate outcome. □

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The New Information Age

The impact of the data-communications revolution on the free market.

by John Jefferson Davis

Dr. Davis is Professor of Theology at Gordon-Conwell Theological Seminary in South Hamilton, Massachusetts, and the author of the book, *Your Wealth in God's World.*

"Whenever you reduce computing cost significantly, you change the world," observed Robert F. Elfant, general manager of the microcomponent group at the Burroughs Corporation.[1] Elfant's comment reflects revolutionary new developments in computer technology, data processing, and telecommunications that are transforming the American economic landscape and challenging much of the conventional economic wisdom. At the same time, disturbing trends in the area of government regulation threaten to stifle these exciting new prospects—developments which may prove to be as crucial for America's future world leadership as the development of atomic fission in the 1940s.

The global datacommunications industry is staggering in its sheer size. In 1984 the top 100 data processing companies in the world had $132 billion worth of business. IBM was number one with gross revenues of $44.2 billion. Lotus Development Corporation, a leading software firm, was number 100 with revenues of $157 million.[2] These corporations represent new wealth-producing entities that Adam Smith could scarcely have envisioned in his own day.

In recent years personal computers have exploded on the American scene as a dynamic cultural and economic force. During 1984 personal computer hardware shipments grew 60 per cent to a hefty $20 billion. By 1989 it is estimated that personal computer sales will top $50 billion—more than mainframe shipments—and personal computer sales could number more than 125 million.[3]

Computer expert John Gantz predicts that very soon the consumer will be able to buy a $4,000 personal computer with 500 times the disk storage, 20 times the memory, and twenty times the power of a 1978 computer at the same price! These dramatic changes, he notes, ". . .

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are comparable to finding in 1990 that your new $10,000 car will travel triple the speed of sound and get from Miami to Seattle on half a gallon of gas.''[4] Such developments show that human ingenuity and creativity can disprove dire predictions that mankind is inevitably doomed to an ever-shrinking economic pie.

What Hath the Microchip Wrought?

Many of these new economic opportunities are being created by advances in chip technology, the tiny silicon microprocessors that are the real ''brains'' of today's computer. Scientists in California's Silicon Valley are now working on units so small that a quarter-inch square chip will contain more than a million transistors—four times the number on today's cutting-edge 256 K memory chips. These new smaller and more powerful microprocessors will make possible consumer products that are far ''friendlier'' and ''smarter'' than anything available today. These ''superchips'' will give rise to mobile, personal robots, and ''silicon secretaries'' that can speak and be spoken to, organize messages, schedule meetings, and issue gentle reminders to absent-minded executives.

Spokesmen for Trilogy Systems Corporation have reported on their company's progress in producing a self-repairing computer chip. Trilogy scientists are putting two or three times as many circuits on each chip as are actually needed to perform a given function. If one circuit breaks down, special diagnostic circuits in the unit detect the problem and divert the signal to another part of the chip. Adding such self-diagnosis and self-repair capability to conventional chips ''could revolutionize the semiconductor business,'' believes Trilogy President Frederick T. White. Trilogy's research is yet another example of the crucial economic truth that in today's world the creation of new wealth is not so much dependent on the extraction of physical resources from the earth as it is on knowledge, insight, and creativity—qualities promoted by a social system that values and fosters human freedom.

The new economic frontiers of the datacommunications revolution are to be found in outer space as well as in the laboratories of Silicon Valley. Communications satellites and the space shuttle are creating burgeoning new markets that did not exist a decade ago.

Today, only nine years after the first backyard satellite receiving station was built by H. Taylor Howard, a professor of electrical engineering at Stanford, perhaps a million Americans now own satellite antennas of various shapes and sizes. It is estimated that 20,000 to 40,000 new home satellite stations are being installed every month, and the pace is quickening. Owners of these systems can receive as many as a hundred different television channels carrying everything from X-rated movies to Russian weather reports to talk shows whose hosts are nuns.[5]

Edwin B. Parker, also of Stanford University, has patented a small earth station with an antenna only two feet in diameter that can receive satellite signals with no interference. The scaled-down dishes allow workers using computer terminals in remote sites to receive data back from the home office at a cost of about 60 per cent of what AT&T charges to carry the same signals on its telephone lines. ''The market opportunity was just sitting there to bypass AT&T,'' noted Parker. News services such as Reuters and Dow Jones have bought 20,000 of

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"Twenty-five years from now the scale of industrial activities in space could rival that of today's computer industry."

Parker's dishes in the last three years, and industry analysts believe that the Stanford scientist and entrepreneur has created a market with a $2 billion annual potential.[6]

The American space shuttle program is creating revolutionary new possibilities not only in the area of national defense, but also in the American economy as well. Twenty-five years from now the scale of industrial activities in space could rival that of today's computer industry. Some analysts believe that space-based materials processing involving drugs, alloys, and crystals could become more important commercially than genetic engineering. Some pharmaceuticals, for example, are worth literally millions of dollars per kilogram because they are used in saving human lives. One such drug, urokinase, an enzyme that dissolves blood clots, can be produced on earth only in minute quantities and at great expense. In the weightless environment of space, production costs of urokinase could be brought down from $1,200 a dose to around $100. This would be a tremendous benefit in light of the fact that bloodclotting disorders kill some 200,000 people every year.[7]

Satellite communications already represents a $3 billion a year business, involving the transmission of television and radio broadcasts, telephone messages, electronic mail, and business data. Sensitive cameras on satellites have sophisticated remote-sensing capabilities that are improving weather forecasts, reducing deaths from hurricanes, detecting air pollution, and assisting geologists in oil, gas, and mineral exploration. According to one estimate, Florida citrus growers save $35 million each year because satellite weather data tell them exactly when to turn on the heaters in their orange groves, anticipating crop-killing frosts.[8] The economic potential of such satellite capabilities is only beginning to be realized.

Telephones and Computers

Corporate leaders are now realizing that computer and telephone technologies are becoming inextricably intertwined. Long-distance calls are routinely routed by computerized switching banks. Office switchboards, or PBX's, are equipped with computers and software that enables telephone conferences and call forwarding. As computers proliferate in offices and factories, they "talk" to one another over telephone lines. In a move which is symptomatic of converging trends in this field, IBM last year bought for $1.3 billion Rolm, a leading manufacturer of PBX's.[9]

For the individual consumer, the newer, computerized "smart" phones offer auto-dial, repeat, and features that answering machines have. "The new machines have the potential to revolutionize office communications," notes computer analyst Paul Freiberger. "They resemble traditional squat black phones about as much as a Hasselblad resembles a box camera."[10] This trend toward the convergence of telephone and computer technologies, like the new developments in space,

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open vast new economic vistas for entrepreneurs who are alert enough to respond quickly to new conditions.

Clouds are beginning to emerge which threaten to darken these bright new economic horizons. Inept and inappropriate forms of government regulation, and protectionist sentiments within the American high-tech industry are disturbing trends in an area which should be among those with the greatest promise for America's economic future.

Domestic computer manufacturers are finding it increasingly difficult to compete with Japan and other foreign producers. American high-tech firms are generally very strong in innovation and new product development, but are not as competitive in the manufacturing area. Most computer terminals, for example, are now being made in Korea, and the Japanese dominate the computer printer and disk drive market. As a result, Silicon Valley executives, long supporters of free-trade, are now beginning to speak in protectionist tones. "I'm not being asked to seek Detroit-style quotas," states Silicon Valley lobbyist Ralph J. Thomson. But he says that many top computer executives are now beginning to question "whether we should retain our unfootnoted free-trade stance."[11]

Part of the industry's problem is the overvalued dollar that inflates the cost of American goods relative to foreign competitors. The overvalued dollar is related in part to the ballooning federal deficit, which in turn attracts foreign investors to treasury bills and other debt-servicing instruments, thus keeping the dollar high relative to other currencies.

More fundamentally, however, American computer manufacturers are losing their competitive edge by investing too little in basic research and development. As business writer John W. Wilson has aptly observed, "Americans save too little, the government spends too much, and the tax system is biased against investment."[12] The consequences of these misplaced economic priorities are now beginning to make themselves felt.

The Coming of Electronic Mercantilism

The danger of inappropriate government regulation in the datacommunications field is another cloud on the horizon. As more and more nations begin to appreciate the importance of telecommunications linked to computers, governments ". . . are beginning to treat information as they once treated goods," commented former Citibank Chairman Walter Wriston. "We are seeing the growth of a kind of electronic mercantilism as sovereigns move to protect their power." Some governments are now requiring that electronic codes used by private communicators to protect their privacy be registered with government agencies. These governments are reacting to the information revolution in the classic manner, notes Wriston, "by attempting to regulate, tax, and control the new technology."[13]

The problems of government regulation of high technology are complicated by national security considerations. Pentagon investigations revealed that the Soviet Union had pirated from the U.S. the manufacturing technology used in the engine that powers the Tomahawk submarine-launched cruise missile. The Soviet counterpart contained a radar guidance system so sophisticated that U.S. officials were convinced that its computer chips were also stolen from U.S. designs.[14]

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"In the new Information Age where decision times can be measured in minutes and seconds, preserving the freedom of human choice is more crucial than ever."

The problems of how to stop such dangerous technology leaks without stifling the freedom and creativity of the private sector is tying U.S. policy makers in knots.

Closer to home, the nation's largest phone company, AT&T, is being hampered by bureaucratic regulations issued by the Federal Communications Commission. The FCC rules require AT&T to keep its telephone operations entirely separate from its computer business. AT&T's splendid research division, Bell Laboratories, invests millions of dollars each year to design software for the company's long-distance network, but is not allowed to share that work with the company's commercial computer division.[15] Such regulations ". . . put the company at a significant disadvantage in the exploding new market for customer services that integrate computers and telecommunications," notes Princeton economist William J. Baumol. Such policies are not only deleterious to AT&T's bottom line, but also affect adversely U.S. technology's position as a whole relative to foreign competitors such as the Japanese.

Where Should We Go from Here?

One way that government can help rather than hinder U.S. high technology's position is by retaining and even expanding tax credits for research and development spending. U.S. research and development expenditures have fallen behind those of our trading competitors as a percentage of gross national product. Military research and development spending, which accounts for nearly half of the country's total outlay of $100 billion, no longer drives civilian technology to the extent that it once did in the 1950s and 1960s.[16] Revising the tax code generally to encourage savings and long-term investment is a key element in any strategy seeking to retain America's competitive edge.

Governments can also help by implementing policies that encourage rather than discourage the free flow of international information. Restoring the effectiveness of our patents and copyrights[17] will encourage innovators to invest time, energy, and money in new ventures, since such policies will give greater assurance that they will be able to reap the benefits of their labors.

In the complicated field of technology transfer and national security, J. Fred Bucy, president of Texas Instruments, Inc., has offered a simple yet valuable suggestion. Instead of trying to control the tens of thousands of end products produced by the American high technology industry, a more workable approach would be to concentrate on the far smaller number of *manufacturing* processes and machines that make the advanced products possible. It may be practically impossible to prevent a foreign agent from obtaining the latest computer chip, but it is far easier to monitor the plants and machines that manufacture the chips. As things now stand, the Pentagon's list of controlled products "is the size of a book, but it should be on five sheets

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of paper," states Bucy. By concentrating on the far smaller number of manufacturing processes, the need for government controls would be diminished and American manufacturers would experience fewer regulatory headaches.

The trend toward deregulation evident under the current administration needs consistent application in the telecommunications industry. In the case of AT&T, for example, the Federal Communication Commission's fears that AT&T's combined activities in the areas of telephones and computers would constitute a monopolistic restraint of trade are unfounded. Since 1980 competition throughout the industry in long-distance service has accelerated enormously. It has been projected that by 1986 the total long-distance transmission capacity of the competitors will be several times larger than AT&T's.[18]

In the area of computer technology, given the dominant position of IBM, there is little danger that AT&T will exercise monopolistic influences in this field. The Federal Communication Commission's rules concerning the artificial separation of telephone and computer activities have made necessary a duplication of capital, labor, and other facilities for AT&T. The net result of these regulations, as William Baumol has noted, has been to favor ". . . AT&T's integrated foreign competition, which are not subject to similar restrictions and which market combined computer and communications services on a global scale."[19]

While deregulation and divestiture have created some uncertanties for the consumer, analysts believe that such policies will justify themselves in the longer run. Economist Manley Irwin of the University of New Hampshire believes that out of the current flux in the telecommunications industry ". . . will result a phenomenal cornucopia of new industries, new services, and new jobs."[20]

In order to harvest fully the rich economic yields of the data-communications revolution, policy makers need to be wise enough to let the market do its work. Deregulation, investment tax credits, and new thinking in the areas of patent and copyright law will help American industry stay competitive in the world economy. In the new Information Age where decision times can be measured in minutes and seconds rather than months and years, preserving the freedom of human action is more crucial than ever. □

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Who Will Control Medical Care?

Recent changes in Medicare make it difficult for patients to retain control over their own medical care.

by Jane M. Orient

Jane Orient, M.D., is in the private practice of medicine in Tucson, Arizona. She is also an associate in internal medicine at the University of Arizona College of Medicine.

Fear that the Medicare trust fund may be bankrupt by the 1990's—about five years from now—has been used to justify a number of changes in the program. As a result, the day of reckoning may be postponed for a few years longer. But the changes in medical practice might be permanent.

In the name of "cost control," Medicare has changed the payment mechanism. Some payments have decreased, and some have increased. But the amount of the payment is far less important than the method for determining it. The stated issue is cost—the real issue is control.

In the original act that created Medicare, Public Law 89-97, July 30, 1965, Congress disavowed any intention of controlling medicine: "Nothing in this title shall . . . authorize any Federal officer or employee to exercise any supervision or control over the practice of medicine . . . or the compensation of any . . . employee of any institution . . . providing medical services."

But as the Medicare carte blanche for expensive services had its predictable effect of skyrocketing expenditures, the folly of the promise of no controls became apparent. Restrictions on the types of covered services were tightened, and the patient deductibles were increased. These measures were perceived, correctly, as a reduction in benefits. Yet the patient and the physician still made the choice about which services would be purchased. Medicare only decided on the reimbursement.

Recent changes, called mandatory assignment and prospective payment, are of a fundamentally different type. The diminution of benefits is not so obvious, but the threat to freedom of choice is far greater. Under these schemes, the check to the "provider"—the physician, hospital, or other agency—is signed by Medicare (or another third party), rather than by the patient. Usually this apparently subtle change is greeted with relief by patients, who no longer have to worry about the amount written on the check. That worry may be replaced by more serious worries about the quality and availability of services, as we shall see. The person or agency that signs the check is the one with the greatest degree of control over the provider.

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"Assignment" means simply that the patient and physician agree that the physician will be paid directly by the insurer (Medicare, Aetna, Blue Cross, etc.) If a physician "accepts assignment" on a Medicare claim, he has agreed to work for Medicare's fee. Medicare will pay 80% of what it determines to be the reasonable fee (based on the code assigned to the procedure, the doctor's past charges for that procedure, and other factors), and the physician is supposed to bill the patient for the remaining 20% (the "coinsurance") and *no more.* Sometimes, physicians waive the 20%—especially if the total fee was inflated to start with. Medicare has now threatened to cut the fees of physicians who routinely fail to collect the coinsurance, assuming that the fee *must* have been inflated.

If the physician does not accept assignment, then the patient is responsible for paying the bill and for collecting from his insurer whatever reimbursement he is entitled to. Most physicians are willing to wait until the patient receives the insurance check, and to negotiate the fee in cases of hardship.

Under the Deficit Reduction Act of 1984, two classes of physicians were created, "participating" and "nonparticipating." (The constitutionality of this act has been challenged. Litigation sponsored by the Association of American Physicians and Surgeons is pending in circuit court.) Participating physicians sign a contract with the government, agreeing to accept assignment for *all* Medicare patients. Nonparticipating physicians may choose to accept assignment or not, on a case-by-case basis. Once he accepts assignment, the physician may not bill for any portion of the bill that Medicare disallows, but collects from the patient the copayment for the fee that is allowed. About 30 percent of physicians have elected to participate. A proposal to make 100 percent assignment mandatory for all physicians treating Medicare patients has been defeated in the Congress.

From the patient's point of view, the participation arrangement might seem ideal. No forms to fill out, no money to pay except for the nominal copayment, and no worry about whether or not the services will be covered. The doctor and his staff take care of all those details. The participating doctors are listed in a little book published by Medicare, and influential groups of senior citizens reinforce the idea that these doctors are the "good guys."

The second innovative "cost containment" method is prospective payment. That means that a predetermined sum is paid to take care of whatever needs happen to come up. The sum may be determined by capitation—so much per head—as in many HMOs (Health Maintenance Organizations). The government is considering ways to encourage more Medicare recipients to sign up for HMOs.

Another type of prospective payment is by the diagnosis. All hospitals now bill Medicare under the DRG (Diagnosis Related Group) system, receiving what is allowed for a particular diagnosis, regardless of how much it costs to take care of the individual patient. Insurance companies, such as Blue Cross, are extending the concept to non-Medicare patients as well. Although so far prospective payment by diagnosis is used only for hospital services, various plans are under study for applying the method to physicians' fees also. This idea appeals to insurers because it makes their payments more predictable. The risk

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Assignment and prepayment seem to make the patient's life so much easier. But the incentives that they create have had unintended consequences.

of overly large costs must now be assumed by the providers of the service, rather than by the insurance company.

Assignment and prepayment seem to make the patient's life so much easier. But the incentives that they create have already had unintended consequences.

Although the "good guys" are not collecting much money directly from the patients, it would be a mistake to think they are not getting paid. Since people tend to do more of what they get paid for, and less of what they don't get paid for (all other things being equal), it's important to wonder just what the third parties are interested in rewarding.

With assigned claims, the activity that actually results in the payment is the submission of a properly prepared and coded claims form. If all the right blanks are filled in, and if the service is one that Medicare approves of, then a check arrives in due time.

Some things do not appear on the claims form, because they are not important to Medicare. But they just might be important to the patient. For example: 1. How much time did the doctor spend? 2. Was the evaluation thorough, or cursory? 3. Was the diagnosis correct? 4. How much did the treatment help?

In other words, Medicare pays for preparing forms, and the doctor makes more money by being more "productive": by "processing" more patient visits into coded forms. Medicare does *not* pay for spending extra time with patients, an activity which conflicts with the demands of high productivity. Doctors who do more complete, time-consuming evaluations, and who do not require the patient to come back frequently, are financially punished.

Getting Paid for not Providing Care

Prospective payment works a little differently. The "providers" get paid the same amount, regardless of how much is done for the patient. So, in effect, they get paid for *not* doing things. The hazards of prospective payment for medical services are really no different from the pitfalls of paying in advance for other things—such as used cars, dancing lessons, or unexamined bags of diamonds.

While the "providers" have incentives to do less under prospective payment, the consumers have the incentive to demand more, in order to get their money's worth. To be sure that patients don't get more service than they are entitled to, every prospective payment system has a UR (Utilization Review) department. UR's job is to deny services that they feel are "unnecessary" although a doctor and a patient have

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requested them. What are the qualifications for that job? According to a newspaper advertisement for a UR clerk at a major HMO, the applicant must be a "high school graduate or equivalent," have good "communication skills," and be able to "work in a fast-paced environment" and to "prioritize duties."

Hospital Utilization Review has become much more stringent since the DRG system went into effect. And most hospitals now have to get permission from Medicare (called "precertification") for most kinds of admissions. Otherwise, the patient's stay will not be covered.

Here are some actual experiences with UR:

- A surgeon wanted to operate on a patient for a hiatus hernia—the stomach bulging up into the chest. The clerk wanted to know how big the hernia felt. Obviously, she didn't know the difference between a hernia into the chest and the "rupture" that makes a lump in the groin.
- An elderly man with Alzheimer's disease became dehydrated and unconscious. His gastrostomy, the opening into the stomach through which he received nourishment, was not working properly. Medicare decided on a "retrospective denial," that is, they announced that they would not pay the bill, *after* the patient had already been admitted to the hospital. The patient was sent home by ambulance—still in a coma—and died a few days later. The decision was eventually reversed, and the brief hospital stay paid for, but only after a lengthy appeals procedure. Although treatment in the hospital would not have greatly prolonged this patient's life, it would have eased his family's burden during his last days.
- A man called the doctor about his ailing wife, and was told that precertification would require several days. He insisted on taking her to the hospital by ambulance anyway, and she was found to have pneumonia and a bowel obstruction. In several days, she would have been dead.
- Cataract surgery is now supposed to be done in an out-patient setting. Medicare denied a claim for a very elderly patient who lived alone in a small town 50 miles away, who was blind in one eye, and unable to see with the other eye for a few days after surgery.

Most doctors could tell a few horror stories like these. Of course, there is also a "quality assurance" committee, which works right alongside Utilization Review. The doctors who do quality reviews don't get paid for it, and if they find a potential problem, it is usually just "trended." Some record is kept, and more reviews may be done. However, the UR doctors are paid, and if *they* find a problem, the patient may be on his way home in an ambulance. And UR is much easier to do. Anyone can see what was done for the patient by reading the chart. But the chart doesn't list all the things that the patient *didn't* receive.

Bureaucracy Controls Medicine

Ironically, although the high cost of medical care is used to justify the changes in reimbursement and the accompanying regulations, nobody knows yet whether they will save any money.

If they do save money, it will not be by reducing *costs,* which are increased by regulation (already about one-fourth of the hospital bill is due to the costs of complying with regulations). UR clerks and

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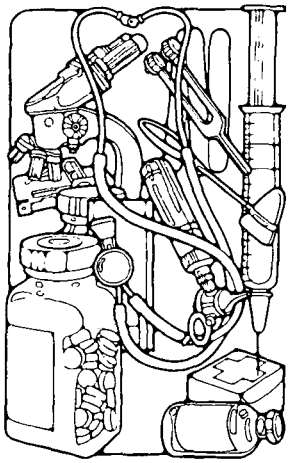
their "physician advisors," computer operators, and clerks to code the DRGs must all be paid. The only savings will be reduced *expenditures*—meaning simply that fewer medical services will be rendered.

Or at least that fewer *unprofitable* medical services will be rendered. Under DRGs, the hospital is reimbursed for the *average* cost of caring for a patient with a particular diagnosis. Some patients cost the hospital less than the average, and the hospital is supposed to make a profit on them. They are called "winners." Patients with expensive illnesses for which Medicare pays too little are called "losers." Hospitals, in order to survive, are supposed to "manage the case mix." That means to bring in more "winners," and somehow to keep out the "losers."



In addition to some doctors and hospitals, others are making profits from Medicare. Manufacturers of computer software are making lots of sales to help the hospitals manage the complex DRG system. Certain medical equipment is heavily advertised because of its hefty profit margin—such as chair lifts, which go for $1500. "Home health services"—which are said to be less expensive than hospital services—are springing up to do *only* those things that Medicare covers. They may not be interested in supplying a low-cost homemaking aide if that's all the patient needs. But they would be happy to send a high-cost physical therapist, occupational therapist, social worker, and nurse (providing that the patient is "certified" to "need" several such services). Medicare pays $44 for a house call by the nurse, and about $22 for a house call by the doctor.

All of these "providers" are following the normal human inclination to take the job that pays best. And those generous people who do things that actually *lose* money—like doctors who make house calls—will soon be out of business. They are "inefficient," to use the popular term.

But don't patients *want* the most "cost-efficient" health care? Maybe not.

For bad diabetic foot ulcers or poor blood supply to the foot, the most cost-efficient treatment is probably to amputate the leg. Prolonged hospitalization for meticulous nursing care and high dose antibiotics don't always save diabetic feet—and they always do cost a lot of money. Bypass operations to bring a new blood supply to the foot don't always work and are also very expensive. The best interests of society would be served by spending the money where it would do more good.

The patient, however, might have a different opinion. He might place such a high value on his leg that he'd be willing to mortgage his house to pay for an operation that might save it. And if he's in real financial difficulties, he might even find a surgeon to donate his services, because it is so much more rewarding to save a foot than to amputate one.

An indemnity insurance plan also pays by the diagnosis, and might allow just enough for the amputation—but the patient would be free to use that payment to defray part of the cost of the more expensive treatment. In contrast, under the DRG system, the amount allowed by Medicare is *all that can be charged.* If the hospital provides a more expensive treatment, it just loses the money, whatever the patient's

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willingness and ability to pay. The patient who wants a noncovered service in a hospital that has a Medicare contract (as nearly all do) could renounce his Medicare benefits altogether, but would then have to pay the *entire* amount himself, not just the excess amount.

The control of medical services cannot be divorced from the payment mechanism. As the payment has become more and more remote from the service and the patient who receives it, the "providers" become less responsive to the choices and preferences of the patient, and more constrained by the requirements of the payers. To correct for the distorted incentives, punitive controls are instituted, increasing costs and creating still more problems.

If a patient assumes responsibility for paying his own medical bill, he takes the risk that the service will not be covered by his insurance. Assignment or prepayment frees him from that worry, but substitutes the risk that the service will not be available to him. For example, in Canada, he would be certain that his CT scan would be covered, but in some areas the waiting time for an "urgent" CT scan is about six months.

Under assignment or prepayment, it appears that providers have assumed the risk of not being paid for their work (or even of losing money) if costs turn out to be high. However, the reality is that patients are being sent home, even in a coma, when the payment runs out.

The responsibility for paying medical bills can be shifted. However, the control over medical decisions must eventually be transferred along with it. The person who signs the check is the one who does the utilization review.

Whom will you choose to control *your* medical services? The government? An insurance company that hires high school graduates to do UR? A doctor who is being paid by the head? An ethics committee? A hospital that is deeply in debt?

Those who would prefer to keep the controls in their very own hands must understand the ominous implications of the current changes in insurance, starting with Medicare, however benevolent they may appear. □

In Future Issues . . .

April

- "A Bad Time for Giants" by John K. Williams
- "Cyclical Unemployment" by Hans F. Sennholz
- "Disasters Unlimited" by John W. Sommer

May

- "The Continuing Plight of Agriculture" by Dennis Bechara
- "Unemployment Compensation" by Hans F. Sennholz
- "Hostile Acquisitions: The Restructuring of Corporate America" by Frank Bubb

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How Democracies Perish

by John Chamberlain

The first thing to say about Jean Francois Revel's *How Democracies Perish* (Doubleday, Garden City, New York, 376 pp., $17.95) is that it was written by a Frenchman. It represents a profound break with the neo-Marxism of the Paris intellectual community, the Gides and the Sartres who, even though they might differ with the Moscow line on some occasions, still considered Marxism-Leninism to be the wave of the future. The book is ably translated by William Byron.

Revel is something of a secular humanist (he likes the United States because it is willing, as he phrases it, to get along without either Marx or Jesus), but his values are Christian nonetheless. As a pragmatist he observes that democracy, with its capitalism, works, and he is certain that, in the long run, the Communist nations of the Eastern bloc are going to collapse. But what frightens him is the prospect that the democracies of the West will fall to pieces while Moscow still packs its ICBM nuclear lead that gives it blackmail power in spite of its own economic weaknesses.

The thesis is similar to that of Schumpeter, who thought that capitalism, though successful, would be fatally undermined by critics who insist on contrasting it to their dream of socialist perfectionism. In the real world, of course, the existing socialist bloc lives off what it can scrounge from nations that depend on market economies.

Revel goes back to Alexis de Tocqueville in order to make a running start. Tocqueville had been greatly impressed by the democracy of the young United States, but he also noticed that when a society becomes richer it rebels against authority "in proportion as its needs are met." The more that claims are satisfied, the greater the clamor for something better. In the third quarter of the Twentieth Century the democracies were more affluent than they had ever been. But, perversely, they tended to be "increasingly unstable, explosive, ungovernable." It is not stagnation that breeds revolutions, says Revel, echoing Tocqueville, "but progress, because it has already created the wealth that makes revolution viable."

The Communist societies don't have this trouble. Says Revel, "Where the State is everything and civilian society is nothing, economic stagnation and social sclerosis foreclose all hope, and the absence of freedom blocks the spread of discontent." The Communist dictators cover their weakness by

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a calculated military expansionism. What we get is the survival of the least fit. It would not be so if the democracies only realized that they could bring about the collapse of Communism by matching it in military might and, at the same time, depriving it of access to western foodstuffs and western technology.

Revel gives us a long history of western failure to unite on a common anti-Communist policy that might have blocked Soviet expansionism. We didn't have to give Stalin the Kurile Islands and the southern half of Sakhalin Island in the Far East, for example. We might have let General Patton's tank forces stay in Prague at the close of military operations in Europe in 1945, which would have given us the "Bohemian bastion" that Bismarck regarded as the key to the continent. We might have beaten the Russians to Berlin if Eisenhower hadn't been ordered by Roosevelt to let the Soviets take Germany up to the Elbe River.

Revel is sarcastic about Roosevelt's feeling that he could "handle" Uncle Joe Stalin by making him laugh and Truman's statement that "old Joe" was a decent sort who couldn't do what he wished "because he was the Politburo's prisoner." "I like old Joe," said Truman a couple of years after Potsdam. But Truman, unlike Roosevelt, lived to make amends for his mistake about Stalin's character, and about Marxism-Leninism in general.

Truman, with his aid to Greece, did manage to check the Soviet advances after World War II. But we never really fought the Cold War as it should have been fought. As for detente, it was a disaster.

The democracies, says Revel, have always failed to reckon with the constancy of the Soviet plan to take over the world by eating it leaf by leaf, like an artichoke. The Soviets never take a single defeat as final. They make tactical retreats, but only to renew their attacks elsewhere. When they were pursuing detente in eastern Europe, they were girding themselves for take-over in Asia, Africa and Central America.

Revel considers our handling of the Polish bankruptcy threat to be symptomatic of our general failure to use economics as a weapon. We were afraid that if we were to force Poland into the political equivalent of a receivership, we would panic all the Third World countries that owed us so much money. We could have handled this fear selectively by refinancing the loans to non-Communist nations while we were denying such favors to the Communists. The Third World would have been grateful, and Moscow would have had to like it or lump it.

Revel thinks it ridiculous that we made $70 billion in loans to the Soviet bloc in the decade of the Seventies. The Communists didn't use this money to feed their own people. Instead, the money went into more and better ICBMs, and into financing subversion around the world.

The Western willingness to lend money at low rates to build the gas pipeline from Siberia to central Europe is another thing that outrages Revel. Looking back, he likes Jimmy Carter for one thing. Carter had enough spunk to embargo American grain sales to Russia.

There could be more of an argument about this than about most of Revel's criticisms, as he himself recognizes. If the Soviets are forced to pay in gold or foreign exchange for wheat, it means that they will have to keep people digging for gold in Siberia. People who are employed in such digging won't be manufacturing tanks and armored lorries to send to Angola or Nicaragua.

This is a first-rate book in spite of small objections to detail. It teaches us that Marxism has a plan for universal conquest, and that we must meet it if we are to live free. □

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Essays: Moral, Political, and Literary
by David Hume
edited and with a foreword, notes and glossary by Eugene F. Miller

Liberty Classics, 7440 North Shadeland, Indianapolis, Indiana 46250 • 1985 • 679 pages, $11.00 cloth

Reviewed by John K. Williams

Students of the freedom philosophy are indebted to Liberty Fund. From that body comes Liberty Classics, a superbly produced series of works of inestimable value to any person desirous of making the acquaintance of the great thinkers of history who defended political and economic liberty.

The latest addition to that series is David Hume's *Essays: Moral, Political, and Literary.* The volume's editor, Eugene F. Miller, has contributed a foreword, notes, and glossary of interest to any reader but invaluable to students of Hume's writings. Included also is a brief autobiographical outline of Hume's life and a moving letter penned by Hume's admiring and fond friend, Adam Smith. Then come no less than forty-nine essays, graced by the subtlety of insight and clarity of expression typical of Hume.

It would be unfortunate if readers of *The Freeman* who peruse this volume merely study Hume's essays dealing with explicitly economic issues (those on trade, interest, and money, for example). Hume's comments on the "Dignity or Meanness of Human Nature," on "National Characters," on "Civil Liberty," on "Passive Obedience," and on the "Study of History" merit thoughtful consideration.

All students of Hume's works will be delighted to find in this volume the full and accurate text of two of Hume's most controversial essays: "On Suicide" and "On the Immortality of the Soul."

The freedom philosophy needs enthusiastic advocates. It also needs informed advocates. Shallowness of historical insight does not become any person who wishes to further the cause of liberty. We all do well to steep ourselves in the works of the great thinkers who have explored and expounded the philosophy that is ours. Liberty Classics has long made available the works of such thinkers in an attractive, and remarkably inexpensive, form. This edition of Hume's essays is a significant addition to an already distinguished series. □

Free Trade: The Necessary Foundation for World Peace
edited by Joan Kennedy Taylor

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Reviewed by Roy A. Childs, Jr.

When, in the eighteenth and nineteenth centuries, the classical liberals took up the cause of free trade against the ruling doctrines of mercantilism, protectionism, and colonialism they did so not only out of a high regard for freedom of commerce. They did so to promote peaceful relations between nations, as well. They believed that by confining the functions of government to the protection of life, liberty, and property, the tensions between nations would gradually disappear, and that free trade would usher in a new era of international harmony, free of the scourge of war.

Today we have the benefit of hindsight, and these liberals seem to have been right. The nineteenth century was the closest we have come to a century of free trade, and peace seemed to follow. The twentieth century, on the other hand, has witnessed the abandonment of laissez faire ideals and the

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growth of statism of all varieties. It is no accident that it has also been the bloodiest century in history. The movement from limited government to unlimited government, from free trade to economic nationalism, has produced a century of conflict and violence.

This volume collects fifteen short essays by thirteen authors, most culled from the pages of *The Freeman* over the past three decades, to put some meat on the bones of this argument. The authors of these essays will for the most part be familiar to *The Freeman's* readers, because they have been frequent visitors here: Bettina Bien Greaves and Hans Sennholz, Henry Hazlitt and Ludwig von Mises, Frederic Bastiat and Frank Chodorov join with others in making out a complex case. They tell us convincingly that free trade not only brings prosperity, but may help peace along, as well.

Frank Chodorov reminds us that "the will to live is not merely a craving for existence; it is rather an urge to reach out in all directions for a fuller enjoyment of life, and it is by trade that this inner drive achieves some measure of fulfillment." People fulfill their needs through production and exchange, and erase conflicts through cooperation, bargaining and voluntary trade. And this process does not stop at a nation's borders. That is why Chodorov finds that "any interference with the marketplace, however done, is analogous to an act of war," and why Mises reminds us that "economic nationalism is incompatible with durable peace."

Unfortunately, in turning our backs to the ideal of limited government, and embracing forms of socialism and the welfare state, we have got more than we bargained for. Once an impartial arbiter of disputes, government has decided to help some citizens at the expense of others. It wants to "protect" some producers at the expense of consumers, by putting roadblocks in the way of free trade. When tariffs aren't enough, as Bettina Bien Greaves points out, they stoop to other kinds of restrictions on trade: "quotas, embargoes, 'Buy American' acts, licensing requirements, quarantines, food and drug standards, antidumping laws," and the like. All of these restrictions are meant to stop domestic consumers from voluntarily buying the products they desire from foreign producers.

A result is the rise of aggressive nationalism, which, as Mises argues, "is the necessary derivative of the economic policies of intervention and national planning. While laissez faire eliminates the causes of international conflict, socialism and government interferences with business create conflicts for which *no peaceful solution can be found.*" (emphasis added)

This book is a call for us to step back from the brink of economic nationalism and trade wars to consider what we are doing. It is concerned simultaneously with principles and reality. And its authors focus clearly on some of the great issues of our time: world hunger, foreign aid, international investment, unemployment and international conflict are all seen through the eyes of principles that enable us to understand what is happening to our world. In doing that, it makes a bold case for the re-examination of the ideals we have so thoughtlessly abandoned: individual rights, private property, economic freedom, limited government and free trade. In the nineteenth century these ideals helped promote peace; in the twenty-first, perhaps they can do so again. □

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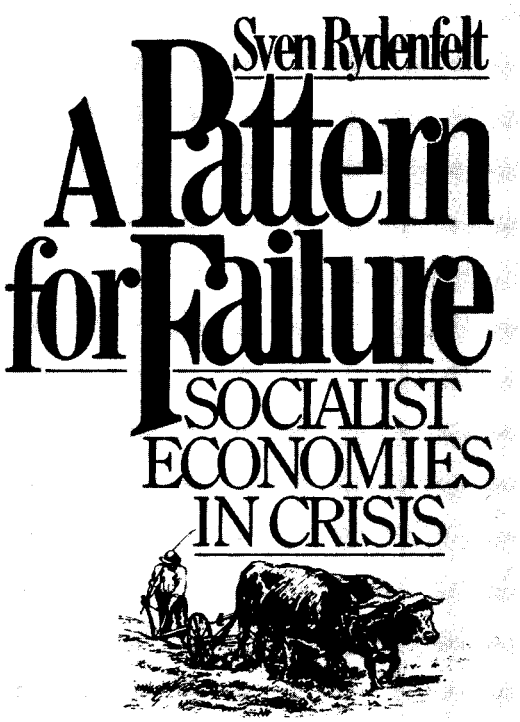

Introduction by Milton Friedman

A Pattern for Failure: Socialist Economies in Crisis, by Swedish economist Sven Rydenfelt, underscores the necessity for our commitment to freedom. He shows how government domination in fifteen socialist countries throughout the world has brought impoverishment and misery to their citizenry.

Dr. Rydenfelt offers the solution to these societies in crisis: "The new ideas of the philosophies of freedom and entrepreneurship are revolutionary in the true sense of the word and will everywhere transform the societies in which they work."

Dr. Rydenfelt's remarkable book performs an immense service in bringing together detailed evidence on the performance of fifteen widely separated countries in which the government plays a dominant role in organizing economic activity. No one who reads Dr. Rydenfelt's account of the course of events in these countries can fail to recognize the uniformity of their experience.

This highly thoughtful, original, and provocative book deserves a wide readership.

—From the introduction by Milton Friedman

Originally published at $22.95, **A Pattern for Failure** is available to Freeman readers at **$10.95**

FEE pays all postage on prepaid orders.

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The Argentine Crisis

The article, "The International Debt Problem: The Case of Argentina" (December), is excellent. Michael Adamson envisages the Argentine state of affairs with more accuracy than many people living in this country.

Deliberately provoked misinformation and a great lack of understanding of political, social, and economic matters have allowed many governments to mislead the Argentine population.

At the end of the 19th century and the beginning of the 20th, Argentina had reached a prosperous situation in the world. It lasted till the early twenties. Prospects and conditions began to decline when rulers got wrong ideas about their duties. Instead of realizing that circumstances had given them a responsibility, they felt anointed by the Almighty to execute His will on earth. The perverse creation called the welfare state was the excuse for those messianic governments to assume missions and to perform charity with plunder taken from some to benefit others. The result of this redistribution of wealth was crisis and poverty for all. There will be no solution to the Argentine problem unless the oversized budget of this bureaucracy is reduced. Further international loans will only make this situation worse.

Congratulations to Mr. Adamson for writing and to *The Freeman* for publishing the facts about such irresponsible behavior.

Pablo Klimann
Buenos Aires
Argentina

The Bishops and Individual Rights

The second draft of the Bishops' letter on the economy is now public. The most that can be said for it is that it's not as bad as the first.

Economic fallacies still abound, as pointed out by the articles by Charles Baird and William Kern in your December issue. But there is an additional political problem.

The only hope we have of limiting the power of government is the rule of law, the nonarbitrary application of general principles based on individual rights. The bishops' proposal that incomes be determined by moral merit would require some individual or group to be aware of all the motives that prompt anyone to do anything and to reward or punish accordingly. Acquiring such information, even were that possible, would be incompatible with the cherished right to be secure in one's home and person.

The bishops do not seem to understand the totalitarian overtones of their own proposal. Eloquent rhetoric about the sanctity of human rights stands next to calls for the government to determine which industries should be "socialized," which regulated, and which left alone. But what is this if not a grant of unlimited arbitrary power to government? The bishops apparently assume that since they are referring to property, human rights are unaffected. Nothing could be further from the truth. The freedom to use one's honestly acquired property is a fundamental human right.

David Osterfeld
St. Joseph's College
Rensselaer, Indiana

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The New Format

As a long time reader of *The Freeman*, I'm very impressed by the new size and design. Efforts like these to revitalize such a well-established publication will undoubtedly expand its audience. I believe that you will attract many new, young readers to join the ranks of those already aware of *The Freeman's* excellent coverage of subjects vital to the cause of liberty.

Andrea Millen Rich
New York City, New York

I'm sorry to say that I don't like your new size for *The Freeman*.

One big advantage to me and, I believe, to others of your prior size was that it would fit into my coat pocket. As a result, it was more handy to take with me to read while I was waiting in offices for appointments.

Why has the *Reader's Digest* its large circulation? I believe its size is one reason.

Harry H. Hoiles
Tustin, California

I was surprised to see the new format and cover of the first 1986 issue of *The Freeman*. It looks most attractive. Did one of your generous sponsors offer to pay that added cost?

I wish FEE every success in its great work. May it move forward in spreading the word on freedom.

George F. Platts
Ormond Beach, Florida

Editors' Note: We would like to thank our readers for their many comments on the new *Freeman* format. Our goal, as always, is to provide the very best in the literature of freedom in an attractive and accessible format. We welcome your comments and support as we move forward in this task.

Coming of Age

Twenty-four years ago I was given a list of several hundred recommended books, most of which I had never heard. It was from these that I discovered *The Road to Serfdom* by F. A. Hayek and became acquainted with *The Freeman* and thus *The Law* by Frederic Bastiat. These put foundations under beliefs and principles I already held but to which I had not given deep thought.

In recent years it has been encouraging to witness a growing awareness that there might be some relation between morality and the free market. The dawning was evident when Leonard E. Read expressed his observations in *Reflections on Coming of Age*, written after twenty-one years of FEE. He had come to the realization that teaching free market economics was not enough, that it was also necessary to stress the virtues that make a moral society.

Would it be proper to suggest that the free market is the natural evolvement from a practicing morality?

Phil Clark
Carthage, Illinois

A Team Effort

I have just read "Production Is a Team Effort," by Bettina Bien Greaves in the December *Freeman*. She has put it so clearly that it seems to me it ought to be sent to all labor leaders in the country.

It is such a shame that many of our basic industries are being priced out of the world market due in large part to excessive wage demands on the part of union leaders.

B.C. Carlson
Weston, Connecticut

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Ideas on Liberty

A new public opinion must be created privately and unobtrusively. The existing one is maintained by the press, by propaganda, by organization, and by financial influences which are at its disposal. The unnatural way of spreading ideas must be opposed by the natural one, which goes from man to man and relies solely on the truth of the thoughts and the hearer's receptiveness for new truth. . . .

ALBERT SCHWEITZER

Where have you been? If you've just discovered THE FREEMAN and have found some helpful ideas, you may want to see our studies regularly. If so, just use the form below to reserve your place on our mailing list. (Any individual in the United States is added at his request. For foreign delivery, extra mailing costs require a charge of $10.00 a year.)

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A free society is fertile and creative in the sense that its freedom generates alertness to possibilities that may be of use to society; a restriction on the freedom of a society numbs such alertness and blinds society to possibilities of social improvement.

—ISRAEL M. KIRZNER
Perception, Opportunity, and Profit

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